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Lights Out for a 401(k) Investment Fund? Don't Forget the Blackout Notice Rules.

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One of your company's 401(k) investment fund options is underperforming. Or, perhaps the fund is no longer appropriate for your employees. Or, perhaps a fund's wildly successful fund manager has jumped ship to another fund company, investors are fleeing the fund in droves, and you do not want your plan to be last off the sinking ship. At any rate, the fund no longer has a place in the plan's investment menu, and it's time for it to go.

With this decision come a number of responsibilities. The plan sponsor may need to convene an emergency meeting of the investment committee, review plan documents and the investment policy statement to make sure that procedures are followed, and identify a replacement fund, among other things. And importantly: the plan sponsor will need to review the Sarbanes-Oxley "blackout notice" rules to see if any participant notice requirements will be triggered by the changes.

How Did the Blackout Notice Rules Come About?

The Blackout Notice Rules arose in response to the Enron debacle of 2001. The Enron story, at this point, has been well told. Enron employees were permitted (and encouraged) to direct their 401(k) investments heavily into Enron stock. This investment strategy worked out well for employees for a time, as Enron stock rose in value. However, Enron's stock went into free fall in late 2001 following poor earnings reports and allegations of wild mismanagement. While the stock value was plummeting, Enron prohibited employees from changing their 401(k) investments. At the end of the slide, many Enron employees were left with worthless 401(k) accounts.[1]

The Sarbanes-Oxley Act of 2002,[2] passed largely in reaction to the Enron crash, contained a number of financial reforms, including increased oversight of corporate governance and enhanced noncompliance penalties. Included in these reforms is a requirement that 401(k) participants be warned well in advance if access to their 401(k) accounts will be restricted.

What Are the Requirements?

Sarbanes-Oxley added a new section 101(i) to the Employees Retirement Income Security Act of 1974, and final regulations were promulgated on January 24, 2003.[3] In sum, these rules require that a plan administrator give plan participants and beneficiaries notice of any period lasting more than 3 consecutive business days during which the ability to diversify investments, obtain loans, or obtain distributions is temporarily suspended, limited or restricted. The notice must be given between 30 and 60 days in advance of the blackout period. The notice must contain specific contents, including the reasons for the blackout period, a description of the affected rights, the length of the period, and contact information. The final regulations contain a model notice.

Does a Change in a Plan's Investment Options Trigger the Blackout Notice Requirements?

Fortunately, the Department of Labor has provided some guidance on this very issue. Replacement of an investment option or a permanent restriction on new contributions to an investment fund does not, in and of itself, trigger a blackout notice requirement. However, if pursuant to such actions the rights to diversify investments or take loans or distributions are suspended, a blackout notice may be in order. Here is an excerpt from the preamble to the final blackout notice regulations:

“

… a permanent restriction on new contributions to an investment option, replacement of one investment option with another, a plan termination and similar types of permanent restrictions would not in and of themselves be events that give rise to a blackout notice obligation under the regulation. However, if, in connection with implementing a permanent restriction, some rights would be temporarily suspended, limited or restricted, the blackout notice requirements would apply to such temporary restriction. For example, in replacing investment option A with investment option B, the plan permanently restricts new contributions to option A and during the transfer of funds from option A to option B temporarily suspends participant direction of the funds transferred to option B for 5 days during which transfers and accounts will be reconciled. In this situation, the restriction on new contributions to option A would not constitute a blackout period, but the 5 day temporary restriction on the direction of funds in option B would constitute a blackout period with respect to which notice must be provided under the regulation. On the other hand, if there was no restriction on the direction of funds in option B or if the restriction was for 3 or fewer consecutive business days, there would be no blackout period with regard to such funds under the regulation.[4]

What Are the Penalties for Noncompliance?

The DOL may assess a civil penalty of up to $100 per day per participant, assessed from the date of the failure to the end of the blackout period.[5]

Next Steps

While blackout notice requirements are not particularly onerous, the penalties for noncompliance can be steep. Employers who are changing 401(k) investment funds are urged to carefully consider whether a blackout notice is required, and, if so, to comply with the blackout notice rules.

If you have any questions about this topic, please contact the author or your principal Mintz Levin attorney.

Endnotes

1**http://www.nytimes.com/2001/11/22/business/employees-retirement-plan-is-a-victim-as-enron-tumbles.html**

2 Pub.L. 107–204, 116 Stat. 745, enacted July 30, 2002

3 68 FR 3716

4 Preamble to the final regulations, 68 FR 3716 (January 24, 3003).

5 ERISA Section 502(c)(7)

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